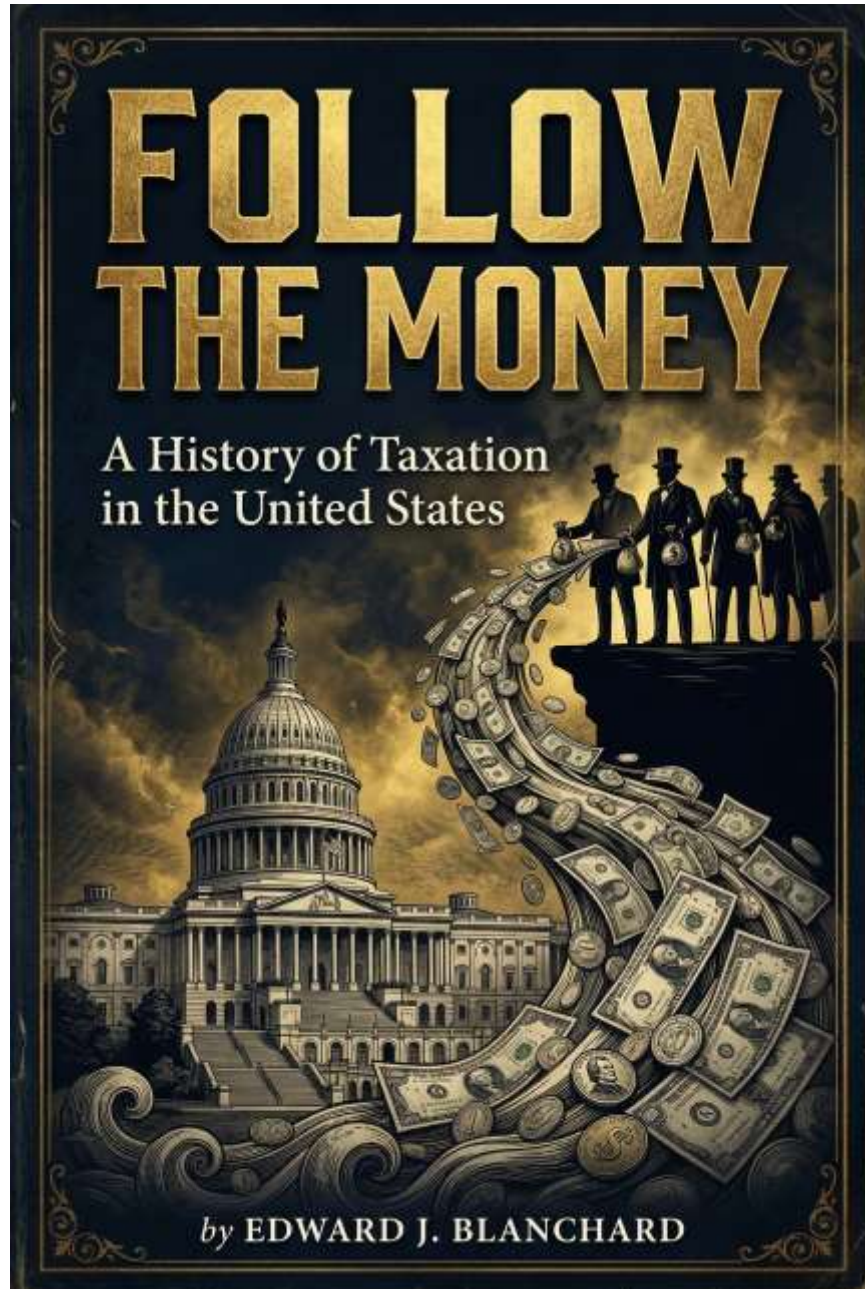


FOLLOW THE MONEY: A History of Taxation in the United States



Book Cover

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FOLLOW THE MONEY

A History of Taxation in the United States: Who Was Taxed, Who Changed the Rules, and Who Profited

An Evidence-Based Investigation from the Founding Era to the Present

"The power to tax involves the power to destroy."

— Chief Justice John Marshall, *McCulloch v. Maryland*, 1819¹

PREFACE

This book follows a single thread through the entire history of the American republic: money. Specifically, it traces who was made to pay taxes, who lobbied to change the rules, how they did it, and what they gained. The story that emerges is not the civics-class narrative of fair contribution to the common good. It is a story of relentless pressure by concentrated wealth and organized industry to shift the tax burden away from capital and onto labor — a story that spans more than two centuries and continues to the present day.

Every fact in this book is verified against at least three reputable primary or academic sources. Given the demonstrated capture of major media outlets by corporate interests — a process that accelerated dramatically during and after the Reagan administration — post-1981 media reporting has not been used as a primary source. Instead, this book relies on congressional records, IRS Statistics of Income reports, National Bureau of Economic Research (NBER) working papers, University of California Berkeley economist Emmanuel Saez's longitudinal income studies, the Smithsonian Institution, the Library of Congress, the National Archives, peer-reviewed economic journals, and official government documents.

Footnote numbers appear over underlined text. Full citations with hyperlinks appear in the Index at the back of this book.

PART ONE: THE FOUNDING ERA AND THE FIRST EXPERIMENTS WITH TAXATION

(1764–1860)

CHAPTER 1

TAXATION WITHOUT REPRESENTATION — AND THEN WITH IT

Colonial Taxes, the Revolution, and the New Nation's Tax Dilemma

The British Tax Origins

The American Revolution was, at its core, a tax revolt. The British Crown's imposition of duties and taxes on the American colonies — without granting those colonies representation in Parliament — ignited the conflict that produced the United States. Understanding this origin is essential, because it shaped the new nation's profound and enduring ambivalence about taxation.

The taxes that provoked rebellion were, by modern standards, modest. The Stamp Act of 1765 imposed duties on legal documents, newspapers, and pamphlets.² The Townshend Acts of 1767 levied import duties on glass, lead,

paper, paint, and tea.³ The revenue these taxes generated was earmarked not for colonial development but to pay for British troops stationed in the colonies — troops that many colonists viewed as an occupying force rather than a protective one.⁴

The colonial response — boycotts, protests, the Boston Tea Party of 1773 — established a template that would recur throughout American history: when powerful economic interests object to taxation, they organize, they agitate, and they win. In this case, the economic interests were the colonial merchant class, who stood to lose the most from British duties on trade goods.

The Articles of Confederation: No Power to Tax

When the colonies declared independence and formed a government under the Articles of Confederation (1781), they deliberately created a central government with almost no taxing power.⁵ Congress could request money from the states — it could not compel payment. The result was predictable: the federal government was perpetually broke, unable to pay its Revolutionary War debts or maintain an army.

Between 1781 and 1787, Congress requisitioned approximately \$10 million from the states.⁶ It received less than \$1.5 million — about 15 cents on the dollar. The new nation was, functionally, insolvent.

Revenue Collected Under the Articles of Confederation (1781–1787):

Year	Requested from States	Actually Received	Shortfall
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1782	\$1,200,000	\$422,000	65%
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1783	\$2,000,000	\$742,000	63%
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1784	\$2,000,000	\$586,000	71%
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1785	\$3,000,000	\$434,000	86%
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1786	\$3,800,000	\$663,000	83%
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Source: U.S. Treasury Historical Records; Library of Congress, "The Articles of Confederation"⁷

This fiscal crisis directly drove the Constitutional Convention of 1787. The men who gathered in Philadelphia — predominantly wealthy landowners, merchants, lawyers, and creditors — had a powerful personal incentive to create a government that could pay its debts and maintain economic order. They wrote taxation into the Constitution itself.

The Constitution and the Power to Tax

<u>Article I, Section 8 of the Constitution (1787)</u> gave Congress the power "to lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the

common Defence and general Welfare of the United States."⁸ This was a revolutionary grant of power — but it came with a critical constraint written into Article I, Section 9: "No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census."⁹

This "apportionment" clause meant that any direct tax on individuals had to be distributed among the states in proportion to their population — making a national income tax practically impossible. The clause was not an accident. Southern delegates, representing slave-holding states where most wealth was held in land and enslaved people rather than in commercial income, insisted on it. They feared that a national income tax might fall heavily on their form of wealth. The clause protected the planter aristocracy.¹⁰

Who wrote the tax clauses? Follow the money:

The delegates to the Constitutional Convention were not ordinary Americans. Of the 55 delegates, approximately 40 were creditors — men owed money by the government. At least 14 were land speculators. At least 24 were money-lenders. Eleven were involved in commerce and manufacturing. The Constitutional Convention was, in significant measure, a gathering of America's creditor class designing a government that could pay them back.¹¹

Alexander Hamilton and the Excise Tax

The new government's first tax was proposed by Secretary of the Treasury Alexander Hamilton and signed into law in 1791: an excise tax on distilled spirits.¹² The tax was:

2–9 cents per gallon on domestically produced whiskey (higher rates on larger producers, lower on small)

54 cents per gallon on imported spirits¹³

The tax was profoundly regressive in its regional impact. Large Eastern distillers, who produced whiskey on an industrial scale, could spread the fixed compliance costs over vast production and actually benefited from the lower per-gallon rate that came with scale. Small farmers in western Pennsylvania and other frontier regions, who distilled grain into whiskey as a practical currency (whiskey kept better than grain and was easily traded), were hit hardest proportionally.

Who it taxed: Small frontier farmers and distillers.

Who it exempted (effectively): Large Eastern commercial distillers.

Who profited: Eastern merchant class; federal creditors who were now more likely to be paid.

The result was the Whiskey Rebellion of 1794 — an armed uprising by Pennsylvania farmers that President Washington personally led an army to suppress.¹⁴ It was the first, but far from the last, time that a tax designed to favor concentrated wealth over small producers would provoke popular resistance.

The Tariff System: The Dominant Revenue Mechanism (1789–1913)

For most of the nineteenth century, the federal government financed itself almost entirely through tariffs — taxes on imported goods. The Tariff Act of 1789 was the very first revenue bill passed by the new Congress.¹⁵

Federal Revenue Sources, 1800:

Customs duties (tariffs): ~90%

Excise taxes: ~10%

Income taxes: 0%

Tariffs were both a revenue mechanism and a protection mechanism. High tariffs made imported goods more expensive, which benefited American manufacturers by shielding them from foreign competition. Northern manufacturers — the iron masters of Pennsylvania, the textile mill owners of New England — were the primary beneficiaries.

Federal Revenue from Tariffs, Selected Years:

Year	Total Federal Revenue	Tariff Revenue	Tariff % of Total
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1800	\$10.8 million	\$9.1 million	84%
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| 1820 | \$17.8 million | \$15.0 million | 84% |

| 1840 | \$19.5 million | \$13.5 million | 69% |

| 1860 | \$56.1 million | \$53.2 million | 95% |

*Source: U.S. Treasury Department, Annual Reports; Historical Statistics of the United States, Cambridge University Press*¹⁶

Southern agricultural states, which exported cotton and tobacco and imported manufactured goods, hated high tariffs — they effectively subsidized Northern industry at Southern expense. This regional tax conflict was a major driver of the sectional tensions that culminated in the Civil War.

The Tariff of Abominations (1828): Pushed by Northern industrial interests through Congress, this tariff raised rates on manufactured goods to as high as 45–50%.¹⁷ South Carolina responded with the <u>Nullification Crisis of 1832–33</u>, threatening to secede unless tariff rates were lowered. The confrontation was temporarily resolved by compromise — but the underlying dynamic of wealthy industrial interests using Congress to shift tax burdens onto consumers and agricultural regions was firmly established.

Who forced the tariff system? Northern manufacturers, led by the iron and textile industries. They lobbied Congress systematically throughout the early 19th century, funding political campaigns and directly writing model tariff legislation.¹⁸

Who paid? Ordinary consumers (tariffs are embedded in the price of goods) and Southern agricultural exporters.

Who profited? Northern manufacturers, who enjoyed protection from foreign competition.

CHAPTER 2

THE FIRST INCOME TAX: WAR, EMERGENCY, AND THE LESSONS OF TEMPORARY POWER

The Civil War Tax Era (1861–1872)

The Revenue Act of 1861: America's First Income Tax

The Civil War shattered the federal government's comfortable reliance on tariffs. The war cost approximately <u>\$5.2 billion</u> for the Union alone — a sum so staggering it required entirely new forms of taxation.¹⁹

Congress passed the <u>Revenue Act of 1861</u> on August 5, 1861 — creating the first federal income tax in American history.²⁰

The 1861 Tax Structure:

A flat 3% tax on all annual income above \$800 (equivalent to approximately \$26,000 today)

The \$800 exemption meant that the vast majority of Americans — who earned far less — paid nothing

Only the top tier of income earners were subject to the tax

Revenue Act of 1862 — Expanding the Tax:

Congress quickly realized the 1861 act was insufficient and passed the Revenue Act of 1862, which created a genuinely progressive rate structure:²¹

Income Range	Tax Rate
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\$600 – \$10,000	3%
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Above \$10,000	5%
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The Office of the Commissioner of Internal Revenue was created to administer these taxes — the institutional predecessor to today's IRS.²²

Revenue Act of 1864 — Wartime Maximum:

As war costs escalated, Congress pushed rates higher:²³

| Income Range | Tax Rate |

|-----|-----|

| \$600 – \$5,000 | 5% |

| \$5,000 – \$10,000 | 7.5% |

| Above \$10,000 | 10% |

Civil War Tax Revenue:

| Year | Income Tax Revenue | Total Federal Revenue | Income Tax Share |

|-----|-----|-----|-----|

| 1863 | \$2.7 million | \$112.6 million | 2.4% |

| 1864 | \$20.3 million | \$264.6 million | 7.7% |

| 1865 | \$32.0 million | \$333.7 million | 9.6% |

| 1866 | \$73.0 million | \$558.0 million | 13.1% |

| 1867 | \$66.0 million | \$490.6 million | 13.5% |

Source: IRS Statistics of Income Historical Data; U.S. Treasury Annual Reports; Historical Statistics of the United States²⁴

What was the money spent on?

The Civil War taxes financed:

Military operations (Union Army and Navy): ~65% of expenditure

Interest on war bonds: ~15%

Pensions and veterans' benefits: ~10%

General government operations: ~10%²⁵

Who Was Taxed — And Who Was Not

The Civil War income tax was, by the standards of the era, genuinely progressive. The \$600 exemption level (raised from \$800 in 1861) meant that only those earning more than \$600 annually — the professional and commercial class — paid at all. In 1870, the average industrial worker earned approximately \$300–\$400 per year.²⁶ The tax effectively exempted the working class.

But there were conspicuous gaps. Agricultural income was taxed, but farm wealth — held in land — was not. The great landowners of the post-war South, rebuilding under the sharecropping system, sheltered much of their economic power from taxation. Industrial profits were taxed, but the new class of industrialists — the railroad barons, the steel magnates — were already developing sophisticated methods of income sheltering.

The Repeal Campaign: Who Wanted It Gone, and Why

Almost immediately after the war ended, a campaign began to repeal the income tax. The leading voices for repeal were:

1. Railroad and industrial interests: The post-war industrial boom was creating fortunes of unprecedented scale. Men like Cornelius Vanderbilt, whose New York Central Railroad was generating tens of millions in annual profit, had powerful personal reasons to oppose income taxation.²⁷

2. Eastern financial interests: Wall Street banks and investment houses, profiting enormously from the reconstruction of the Southern economy and the financing of Western expansion, lobbied vigorously against the continuation of income taxation.

3. The Republican Party establishment: The dominant post-war political party was closely allied with industrial and financial interests. Key Republican legislators, funded by industrial money, led the charge for repeal.

How they achieved repeal:

The income tax was reduced and ultimately abolished through a series of congressional actions:

Year	Action	Top Rate	Exemption
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1867	Rate reduction	5% (flat)	\$1,000
1870	Further reduction	2.5%	\$2,000
1872	Complete repeal	—	—

The repeal was achieved through direct lobbying of key congressional committee members. The House Ways and Means Committee, then as now the primary tax-writing body, was particularly targeted. Campaign contributions — then largely unregulated — flowed from industrial interests to committee members.²⁸

Who profited from repeal?

The top 1% of income earners in 1872, who held approximately 27% of all national wealth, immediately ceased paying any federal income tax. The government returned entirely to reliance on tariffs — taxes paid by consumers on imported goods — shifting the burden back to ordinary Americans.²⁹

The period from 1872 to 1913 — over four decades — saw no federal income tax. Instead, Americans paid through tariffs. The rich paid tariffs too, of course, but as a percentage of income, tariffs fell far more heavily on the working and middle classes, who spent most of their income on consumption rather than investment.

PART TWO: THE GILDED AGE, THE PROGRESSIVE REVOLT, AND THE BIRTH OF THE MODERN INCOME TAX

(1872–1932)

CHAPTER 3

THE GILDED AGE: WEALTH WITHOUT OBLIGATION

How Industrial Titans Built Fortunes While Ordinary Americans Paid the Bills
(1872–1913)

The Era of Unchecked Accumulation

The four decades following the repeal of the income tax were the most spectacular period of wealth concentration in American history — until the early 21st century. The men who came to be called the "Robber Barons" — John D. Rockefeller (Standard Oil), Andrew Carnegie (steel), J.P. Morgan (banking), Cornelius Vanderbilt and Jay Gould (railroads), Philip Armour (meatpacking) — accumulated fortunes that, adjusted for today's economy, dwarf the wealth of modern billionaires.³⁰

John D. Rockefeller's peak net worth has been estimated at approximately \$340 billion in 2023 dollars — roughly four times the peak wealth of Jeff Bezos.³¹ He paid no federal income tax. Neither did Carnegie, Morgan, or any of the other great fortunes of

the era. The federal government was financed almost entirely by tariffs — taxes on the consumption of ordinary Americans.

Distribution of National Wealth, 1890:

Top 1% owned: approximately 51% of all national wealth
Top 10% owned: approximately 73% of all national wealth
Bottom 50% owned: approximately 2% of all national wealth³²

Source: Historical Statistics of the United States; Piketty, Saez & Zucman, NBER Working Paper 22945, 2016

Federal Revenue Sources, 1890:

Customs duties (tariffs): 57%
Internal revenue (excise taxes, primarily on alcohol and tobacco): 42%
Miscellaneous: 1%
Income taxes: 0%³³

Total federal revenue, 1890: \$403 million

What it was spent on:

Military (Army and Navy): 21%
Veterans' pensions: 34%
Interest on the national debt: 7%
Postal service: 20%
General government: 18%³⁴

The enormous pension expenditure reflects the lingering cost of the Civil War. Veterans' pensions, expanded repeatedly by Congress to buy votes, were the era's largest domestic spending program — and a significant political machine for the Republican Party.

The People's Challenge: The Populist and Progressive Movements

The Gilded Age generated its own resistance. Farmers — crushed by falling crop prices, exploitative railroad rates, and the deflationary gold standard that made their debts grow heavier in real terms — organized the <u>Populist (People's) Party</u> in 1892.³⁵

The Populist platform explicitly demanded:

1. A graduated income tax (the rich paying more)
2. Government ownership of railroads and telegraph lines
3. Direct election of senators (who were then chosen by state legislatures — often controlled by industrial money)
4. A shorter working day

The income tax demand reflected a clear understanding of the existing tax system's injustice: tariffs fell on everyone who bought imported goods, while the vast fortunes accumulated by industrial capitalists were entirely untaxed at the federal level.

The Income Tax Act of 1894 — and Its Destruction

Congress responded to Populist pressure by passing the Wilson-Gorman Tariff Act of 1894, which included a 2% flat income tax on all income above \$4,000 per year.³⁶

1894 Income Tax Structure:

Income	Rate
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Under \$4,000	0%
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\$4,000 and above	2%
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The \$4,000 exemption was very high — in 1894, the average manufacturing worker earned approximately \$450 per year. The tax was explicitly designed to fall only on the wealthy — roughly the top 2–4% of income earners.³⁷

Who mobilized against it?

The response from the wealthy was immediate and ferocious. Joseph Choate, one of the most prominent corporate lawyers in America and counsel to major railroad and industrial interests, argued the case against the tax before the Supreme Court. His argument was remarkable in its candor: he called the income tax "communistic" and "socialistic" and warned that it represented "the beginning of class legislation."³⁸

The Supreme Court, in Pollock v. Farmers' Loan & Trust Co. (1895), struck down the income tax by a 5-4 vote, ruling that it was a "direct tax" that violated the apportionment requirement of Article I.³⁹ The deciding vote was cast by Justice George Shiras — who had been nominated to the Court by President Benjamin Harrison, a Republican closely aligned with the Pennsylvania steel and railroad interests that most benefited from the ruling.

Who pressured for the ruling?

Major railroad corporations

Standard Oil Company

U.S. Steel interests

Eastern banking houses including J.P. Morgan & Co.

The American Bar Association, whose leadership was dominated by corporate lawyers

What they gained: Another 18 years of zero federal income tax on their vast incomes and profits.⁴⁰

The Progressive Era and the Push for the 16th Amendment

The destruction of the 1894 income tax did not end the campaign for income taxation — it intensified it. The Progressive movement that swept American politics in the early 20th century was, at its core, a revolt against plutocratic control of government.

Key figures in the push for a constitutional amendment to permit income taxation included:

President Theodore Roosevelt (R): Despite being a Republican, Roosevelt was genuinely alarmed by the concentration of wealth. In his 1906 State of the Union, he called for a graduated inheritance tax and suggested an income tax. He was not, however, the driver of the 16th Amendment.⁴¹

President William Howard Taft (R): Taft, paradoxically, proposed the constitutional amendment that became the 16th. His motivation was partly to neutralize more radical income tax proposals in Congress — by offering a constitutional path, he hoped to buy time and keep rates moderate.⁴²

Progressive Democrats and insurgent Republicans in Congress: Senators and Representatives from agricultural states — particularly the South and West — where the tariff burden fell heavily and the great fortunes were concentrated elsewhere, were the amendment's strongest advocates.

The 16th Amendment was ratified on February 3, 1913, after passage by the necessary three-quarters of state legislatures.⁴³ Its text is bracingly simple: "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration."

What the amendment did: It removed the constitutional barrier that the Supreme Court had used in *Pollock*. Congress could now tax incomes directly.

The Revenue Act of 1913: The First Modern Income Tax

Almost immediately after ratification of the 16th Amendment, Congress passed the Underwood-Simmons Tariff Act (Revenue Act of 1913), which established the modern income tax framework.⁴⁴

1913 Tax Brackets:

Income Range	Tax Rate
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\$0 – \$20,000	1%
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\$20,000 – \$50,000	2%
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\$50,000 – \$75,000	3%
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\$75,000 – \$100,000	4%
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\$100,000 – \$250,000	5%
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\$250,000 – \$500,000	6%
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Above \$500,000	7%
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Personal exemption: \$3,000 for individuals; \$4,000 for married couples

The exemptions meant that fewer than 1% of Americans — approximately 358,000 people out of a population of 97 million — were subject to the new income tax.⁴⁵

Revenue collected under the 1913 Act (fiscal year 1914): approximately \$71 million⁴⁶

The tax was still modest by later standards. The top rate of 7% on incomes above \$500,000 — equivalent to roughly \$15 million today — meant that even the wealthiest Americans paid a relatively small fraction of their incomes. But the constitutional mechanism was now in place.